Domtar Limited

1976 Annual Report

Highlights

	1976	1975
Financial		
Sales	**$886,768,907**	$815,221,364
Income taxes — Current	**$ 3,730,000**	$ 11,930,000
Income taxes — Deferred	**$ 4,170,000**	$ 11,970,000
Net earnings	**$ 10,562,617**	$ 35,287,514
Cash flow from operations	**$ 49,788,131**	$ 76,311,177
Working capital	**$247,963,914**	$219,192,639
Capital investments	**$ 48,091,027**	$ 56,932,267
Funded debt — long term	**$190,499,000**	$150,101,000
Shareholders' equity	**$333,911,672**	$338,711,546
Number of preference shareholders	**1,613**	1,654
Number of common shareholders	**23,330**	25,815
Common shares outstanding	**14,827,300**	14,827,300
Number of employees	**17,520**	17,637
Employees' salaries, wages and benefits	**$273,858,000**	$232,948,000
Per Common Share		
Earnings	**$ 0.68**	$ 2.34
Dividends	**$ 1.00**	$ 1.60
Cash flow	**$ 3.32**	$ 5.11
Shareholders' equity	**$ 21.67**	$ 22.00

The annual meeting of Domtar Limited will be held at 4 p.m. on Tuesday, April 26, 1977 in the Chateau Champlain Hotel, Montreal.

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Les actionnaires qui préféreraient recevoir leurs rapports en français voudront bien en aviser le Secrétaire de Domtar Limitée.

Report of the Directors to the Shareholders

The outlook for 1976, as expressed in the 1975 Annual Report, indicated that, despite adverse economic trends which would particularly affect the Company's pulp and paper operations, a reasonable overall profit performance could be expected. During the year, however, it became apparent that these expectations would not be realized due to all significant cost factors increasing at a faster rate than those in the United States and the intensity of competition from that country. In addition, the Company's results were seriously affected by labour unrest, both internally and externally, throughout the year.

Performance of the Chemicals group was very good despite several prolonged strikes in customer operations. The profits from the sales of several high cost and obsolete facilities contributed to this performance.

Results from the Construction Materials group were significantly down from those in 1975 due to import competition, work stoppages within the construction industry as well as within the group and an unfavourable sales product mix.

Despite the performance of the Packaging company, with net earnings above the 1975 level, the Pulp & Paper Products group experienced an operating loss for the first time in the Company's history. This was largely due to strikes at six of its primary producing mills during the first quarter of the year; the greatly reduced margins arising from American competition in the Canadian and United States markets; and the losses incurred in starting up the new stud mill at Lebel-sur-Quévillon and the new lumber operation at Dolbeau, both in Quebec. Heavy one-time expenses were also incurred at the Dolbeau newsprint mill in connection with a major project to install modern drive and dryer sections on the two machines there.

Your Directors are concerned by the absence of encouraging indicators in the Canadian economy and, in particular, by the growing inability of Canadian manufacturers to be cost competitive with their counterparts in the United States. Notwithstanding the continued rise of labour costs in 1976 at a faster rate than in the United States, there are signs that Government and organized labour now share the recognition by Canadian business that, unless the upward movement of these costs is arrested, the consequences could be disastrous for the Canadian economy. Policy initiatives by Government in this area are awaited with interest. Nevertheless, spending by governments of approximately 42% of the Gross National Product is viewed as an unacceptable burden which the Canadian economy cannot long support. Such a high level of expenditures stems from the continuing high expectations of every sector of Canadian society.

The recent fluctuations in the relative value of the Canadian to the U.S. dollar are clearly an economic response to Canada's trading position. Although they will provide some relief to the cost-price push to which Canadian manufacturers are subject in domestic and export markets, they will, by leading to higher prices for imported goods, exert additional upward pressures on costs.

Sales and Net Earnings

Sales amounted to $886.8 million in 1976 compared with $815.2 million in 1975. Net earnings for the year totalled $10.6 million or 68 cents per common share (including 6 cents per share from gains on the disposal of fixed assets) compared with $35.3 million or $2.34 per common share in 1975 (including 20 cents per share from gains on the disposal of fixed assets).

Although the impact upon the Company and its Canadian subsidiaries of the controls in the Anti-Inflation Act on prices, profits, compensation and dividends was minimal, an excessive amount of management's time was expended in responding to changes in anti-inflationary concepts and regulations and in processing the associated paperwork.

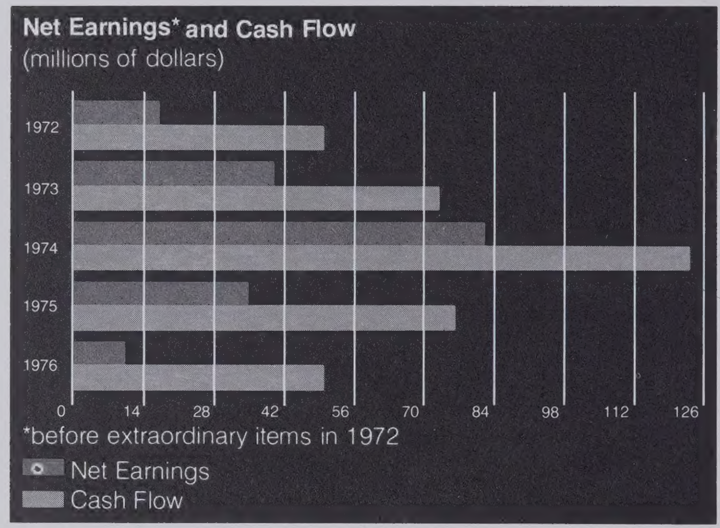
The cash flow in 1976 was at an unacceptable level. It amounted to $49.8 million against $76.3 million in 1975, a decline of approximately 35% as compared with a drop of approximately 70% in net earnings. This decline significantly affects the Company's ability to generate internally the funds required to sustain existing operations.

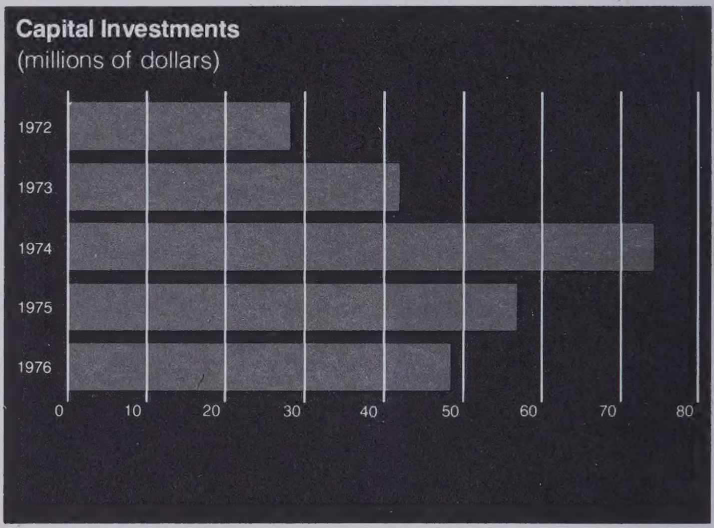
An analysis of sales and earnings before income taxes and minority interest by Domtar's three main product groups for the years 1976 and 1975 is provided in the following table.

(Millions of dollars)	1976		1975	
	Sales	**Earnings**	Sales	Earnings
Pulp and Paper	**$561.8**	**$ (3.2)**	$508.9	$ 22.7
Construction Materials	**172.0**	**10.3**	160.1	16.2
Chemicals	**153.0**	**16.9**	146.2	20.1
	$886.8	**24.0**	$815.2	59.0
Gains (losses) on the disposal of fixed assets:				
Pulp and Paper		**—**		0.6
Construction Materials		**(0.9)**		1.2
Chemicals		**2.5**		2.0
		1.6		3.8
Earnings before unallocated items		**25.6**		62.8
Less: Unallocated items — Corporate income and interest		**6.0**		2.5
Earnings before income taxes and minority interest		**$ 19.6**		$ 60.3

Dividends

The Board of Directors, anticipating a continuation of the uncertain and adverse economic environment, decided at the June 1976 meeting to reduce the quarterly dividend from 40 to 20





cents per common share. No further action in this regard has been taken but the Directors will be watching the situation closely as both the economic environment and the related profit results evolve during the year. The Company declared dividends of $1.00 per share on its preference shares during 1976.

Capital Investment Program and Related Financing

In recognition of the need to improve its cost competitiveness by rationalizing product lines, consolidating production facilities and exploiting opportunities for development in North America, the Company invested $48.1 million in order to add to and expand its manufacturing and distribution facilities. Some details of these expenditures, as well as reference to sales and consolidation of operations, are given in the Reports on Operations.

In order to ensure that the Company had sufficient funds available for these purposes, it was considered advisable in mid-1976 to take advantage of favourable differentials in interest rates between the Canadian and United States markets by raising additional resources for its long term capital program. Accordingly, a $50 million issue of 20 year 9⅝% Sinking Fund Debentures was successfully placed in the United States. As a consequence, the Company's total funded debt outstanding on December 31, 1976, after the $8.4 million of repayments made during the year in respect of sinking fund obligations under previous issues, amounted to $191.0 million, a net increase of $40.9 million.

Source and Use of Funds

In these days of continued high inflation, the Source and Use of Funds statement, which profiles a Company's financial position in current dollar terms, provides a better basis from which to view a company's financial performance than the balance sheet and net earnings statement which contain a mixture of current and historical value dollars.

The table on page 5 summarizes the source and use of funds of the Company over the last five years and indicates the ever increasing need for the Company to generate more funds from operations in order to maintain its existing facilities in good condition, finance the additional working capital required in an inflationary environment, seek new opportunities to expand its product line base and provide its shareholders with a return on their investment. Over the five years, the common shareholders have received, by way of dividends, an approximate 6% cash return per year on the book value of their shares.

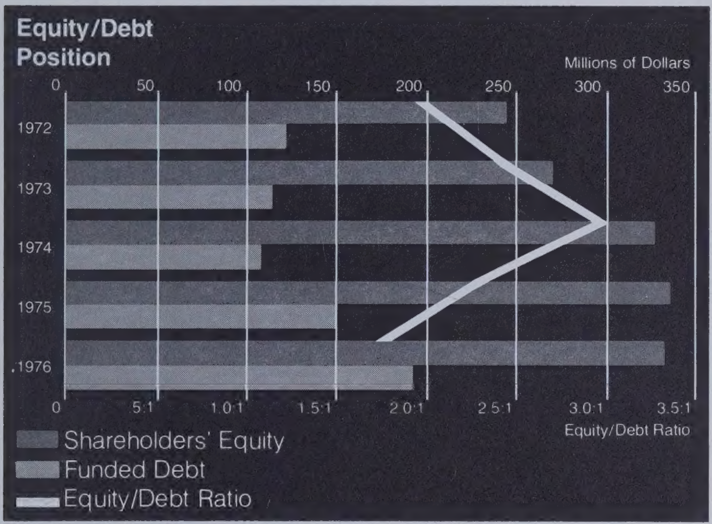
The five year profile indicates that it was necessary to raise additional funds in 1975 and 1976 in order that the Company's ongoing capital expenditure and acquisition programs would be adequately financed.

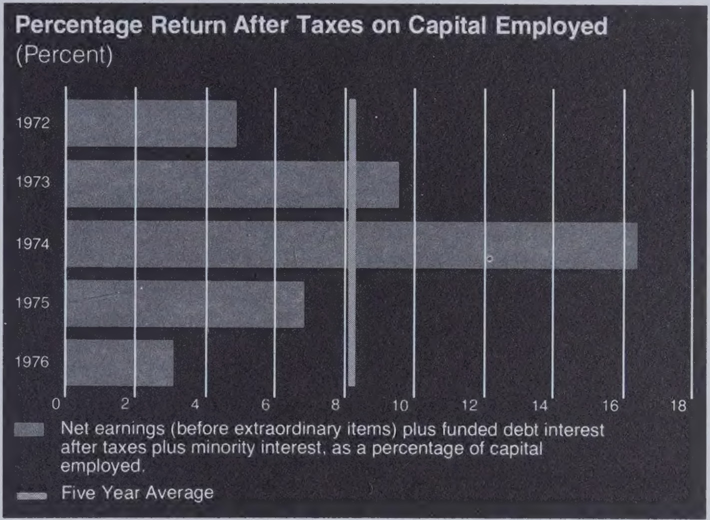
Return on Investment of the Common Shareholders

The return on investment of the common shareholders in 1976 can only be characterized as most disappointing. It amounted to 3.1% for that year compared to 10.7% for 1975. By applying price level inflation accounting concepts, which more accurately reveal the relationship of earnings to the current value of the assets utilized to achieve them, the return on investment becomes a negative figure of 1.7% for 1976 against a positive figure of 4.3% for 1975.

Working Capital

The working capital position continues to reflect the inflationary demands on cash to support the level of activity of the Company's operations. Despite the significant reduction in net earnings experienced by the Company during 1976, investment in working capital attendant to sales increased by $8.6 million. This increase resulted mainly from the return to near normal activity levels of the Company's pulp and paper operations during the latter part of the year in contrast to the end of 1975 when a significant number of primary mills were strikebound. Over the past five years, the net increase in operating working capital has aggregated $32.1 million, mainly reflecting the significant impact on capital required to sustain inflated sales and costs during the last three years. Neither the Federal nor the Provincial taxing authorities nor the Federal government's anti-inflation legislation provide any tax relief for such additional investment and, because the Canadian





Statement of Source and Use of Funds
year ended December 31

	5 yr. total	**1976**	1975	1974	1973	1972
				(millions of dollars)		
Funds provided by the manufacture and sale of products	**$373.8**	**$ 49.8**	$ 76.3	$123.6	$ 73.7	$ 50.4
Proceeds from the disposal of —						
Major fixed assets	**23.0**	**3.0**	3.9	—	16.1	—
Investments (net)	**11.5**	**0.5**	4.8	7.4	—	(1.2)
	408.3	**53.3**	85.0	131.0	89.8	49.2
Funds required for:						
Maintaining existing facilities	**194.5**	**36.0**	40.1	59.5	33.4	25.5
Additional investment in working capital (excluding taxes payable) attributable to the impact of inflation on production costs and selling prices	**32.1**	**8.6**	(33.5)	51.1	3.7	2.2
Changes in income and other taxes payable	**(3.0)**	**1.8**	35.8	(21.6)	(15.4)	(3.6)
Redemption of funded debt	**42.6**	**8.4**	8.0	7.1	7.9	11.2
Other	**8.3**	**1.1**	1.1	2.8	2.2	1.1
	274.5	**55.9**	51.5	98.9	31.8	36.4
Funds available for distribution to shareholders and for new investments	**133.8**	**(2.6)**	33.5	32.1	58.0	12.8
Used for:						
Dividends	**88.1**	**18.4**	24.3	26.5	9.5	9.4
Investment in new facilities and acquisitions	**66.1**	**20.0**	17.3	13.4	12.4	3.0
	154.2	**38.4**	41.6	39.9	21.9	12.4
Balance of funds before financing	**(20.4)**	**(41.0)**	(8.1)	(7.8)	36.1	0.4
New issues of funded debt	**97.9**	**48.9**	49.0	—	—	—
Increase (decrease) in cash	**77.5**	**7.9**	40.9	(7.8)	36.1	0.4
Cash, net of bank indebtedness, at beginning of period	**9.4**	**79.0**	38.1	45.9	9.8	9.4
Cash, net of bank indebtedness, at end of period	**$ 86.9**	**$ 86.9**	$ 79.0	$ 38.1	$ 45.9	$ 9.8

taxing authorities do not permit the use of LIFO (the "last in, first out" basis of inventory valuation), the Company was required to pay full tax on income which, in reality, was not earned.

Despite the issue of an additional $50 million of long term debt during the year, the net cash position of $86.9 million at December 31, 1976 reflected a net increase of only $7.9 million during the year.

The overall working capital position of the Company remains strong with the ratio of current assets to current liabilities being approximately 3 to 1.

Research
Substantial progress was achieved during 1976 on a number of projects undertaken on behalf of the operating companies with a view to developing new products, improving the marketability of existing products and increasing the efficiency of manufacturing processes.

In this regard, the following projects deserve mention. A modified whole tree chipper was developed to separate twigs and grit from the chips and a prototype unit is in operation at the Cornwall, Ontario, fine papers mill. A line of asbestos-free drywall finishing products was developed for market introduction in 1977. Market response to a progressive, battenless and moveable office system introduced in 1976 is encouraging. Technical assistance was provided in the start-up of the new Jagenberg on-machine coater in the Cornwall fine papers mill and in bringing on stream the thermo-mechanical pulping system in the Donnacona, Quebec, groundwood specialty mill.

Considerable attention was directed to the study of problems relating to mercury. Significant progress was made to further minimize emissions from the Lebel-sur-Quévillon, Quebec, pulp mill with the improvement resulting from the application of the Domtar Turbulent Contact Absorber. At the same time, substantial progress continues to be made in developing a much clearer understanding of the origin and behaviour of mercury in the environment.

The Working Environment
Concerted efforts were directed during 1976 towards continuing improvement of the working environment at the Company's production facilities. To this end, each operating company attempted to implement innovative procedures aimed at accelerating progress. An in-depth study to improve inter-action between employees, unions and the Company is currently in progress in conjunction with several other newsprint producers.

Accident Prevention
Throughout 1976, management continued to concentrate its efforts on reducing the number of accidents and, to this end, new safety programs were launched and the process of consultation with the workers emphasized. Despite these efforts, results showed only a modest reduction in both the number and the severity of accidents incurred by employees. It should be mentioned that seven plants received safety awards during the year.

Labour Relations
As of December 31, 1976, Domtar was a party to 120 collective agreements covering the working conditions of approximately 12,800 employees in Canada and the United States.

During the year, the Company was involved in a total of 89 negotiations, of which 40 were initiated in 1975. There were 69 settlements, leaving 20 negotiations to be concluded in 1977.

The major bargaining activity throughout 1976 centred on the pulp and paper operations. At the start of the year, the Company was still negotiating the renewal of 19 expired agreements in the primary mills under the jurisdiction of the Canadian Paperworkers' Union. The Eastern Canada Newsprint Group, of which the Company is a member, established the basic settlement pattern in February, bringing to an end the longest and most extensive strike action in the history of the Canadian pulp and paper industry. By the end of 1976, the Company was involved in the renewal of all agreements in the remainder of its primary paper mills which are under the jurisdiction of the Confederation of National Trades Unions.

No fewer than 45 work stoppages, an unprecedented number, occurred during the year, seven of them being initiated in 1975. Illegal stoppages totalled 23, of which 19 occurred on the October 14 "Day of Protest." During the year, 6,792 employees forfeited 208,414 man-days of work, equivalent to the loss of 817 full-time jobs, or 6% of the unionized work force, for the entire year.

During the year, the rationalization of production facilities resulted in the total or partial closure of four plants involving 133 unionized employees. The Domtar Industrial Conversion Plan (DICP), which is administered by a joint labour-management committee and is financed by Domtar, was available to the affected employees. The plan is designed to assist in relocation to other employment and to supplement existing government programs.

Public Affairs
The Company's concern at the adverse factors affecting the environment for Canadian manufacturers and the absence of any improvement in all significant cost factors has already been expressed in this Report. This concern prompted management to initiate a series of meetings with officials of the two senior levels of government and with Members of Parliament representing ridings in which Domtar's manufacturing and distribution facilities are located. The purpose of the meetings was to bring the Company's economic perceptions and concerns to the attention of key public servants and elected representatives, discuss these views openly and frankly and initiate continuing dialogue.

In July 1976, the Company published as a paid advertisement in a number of leading Canadian daily newspapers an open letter

to the Honourable Donald Macdonald, Minister of Finance, on the subject of the revised anti-inflation regulations. The Company views these as unrealistic, discriminatory and complex and as creating costly and counter-productive problems. The letter stated in part: "There is no evidence that the Government understands that, in a business such as Domtar, what is left over, after paying salaries, wages, power and raw material costs, government taxes and dividends is re-invested in the Company to maintain its health and enable it to survive.

"Inflation will not be reduced by increasing costs and restricting supply. We must have more goods and services at lower costs and lower prices... We would like to be convinced that Canada remains a land of opportunity compared with other areas of opportunity open to us."

On the subject of the anti-inflationary controls, the Company's view is that restraints on prices, profits, compensation and dividends should be discarded without delay, provided that effective means are established to protect the private sector from uneconomic wage settlements negotiated in the public sector.

Donations to registered Canadian charitable organizations totalled $316,150 in 1976 against $343,000 in 1975. Of this sum, 52% was provided to support health and welfare organizations, 36% was directed to educational institutions and scholarships, 9% to community and civic causes and 3% to cultural activities. With the Company's encouragement, Domtar employees in all operating locations continued, through voluntary participation, to work for the success of diverse community activities ranging from major fund raising appeals to local improvement projects. In support of parliamentary democracy in this country, the Company's contributions to Canadian political parties amounted to $41,950.

Outlook for 1977

The outlook for 1977 is not optimistic. Economic growth rates in Canada and the United States are not expected to exceed the levels attained in 1976. Inflation will continue to be a major factor. A positive element is the expectation that fewer strikes should be experienced than in 1976. The question of competitiveness with the United States is the single most important factor which will confront much of Canadian industry and Domtar throughout 1977.

Although the Company's competitive position varies across its product lines, its cost base is extremely high by comparison with American manufacturers notwithstanding that the standards of modernness and productive efficiency of its manufacturing facilities are at the levels prevailing in the United States. The indicators for all operating companies show significantly reduced profit margins largely because of their inability, due to intensified competition from the United States, to offset cost increases by increasing prices. As a result, these companies are not generating sufficient cash to modernize their facilities, capitalize on new technology or seize new market or product opportunities.

For these reasons, the Company will continue rigorously to restrain all costs which it directly controls. Personnel and services at the corporate level have already been cut in order to reduce overheads. The operating companies have also taken steps to reduce expenses and manning levels. This process is not without risk since the curtailment of certain corporate services provided to the operating companies may impair the quality of decision making. However, the objective of the program is to minimize such risks and to maximize the benefits of increased productivity from the corporate staff and operating company groups.

The balance sheet of the Company is strong. Low performance businesses must be turned around or action taken for their disposal. Funds are available for investments in viable businesses to reduce costs of labour, energy and raw materials and for the exploitation of any new business opportunities which are identified.

The recent election of the Parti Québécois in Quebec creates a new environment for all businesses and individuals with interests in that province. Domtar will continue to work with the Provincial government to further the development of the economy. Provincial policies will be assessed with the objective of ascertaining the opportunities they present to the Company.

Board of Directors

It is with regret that we record the death on May 9, 1976 of Mr. Nathan Pitcairn who had been a Director of St. Lawrence Corporation Limited since 1950 and joined the Board of Directors of Domtar in 1961 shortly after St. Lawrence became a subsidiary of Domtar. The Directors extend their deepest sympathy to his family.

It is proposed that Mr. Pierre Côté, C.M., President, Laiterie Laval Limitée, be elected to fill the vacancy.

Appreciation

Special appreciation and thanks are expressed by the Directors to the more than 17,500 Domtar employees who in 1976 put $768 million of assets to work. Their skill, dedication and hard work in, at times, difficult operating conditions made possible the Company's success during a period of growing economic complexity.

On behalf of the Board

Maxwell C. G. Meighen
Chairman of the Board

Alex D. Hamilton
President and
Chief Executive Officer

Report on Operations
Domtar Pulp & Paper Products Ltd.

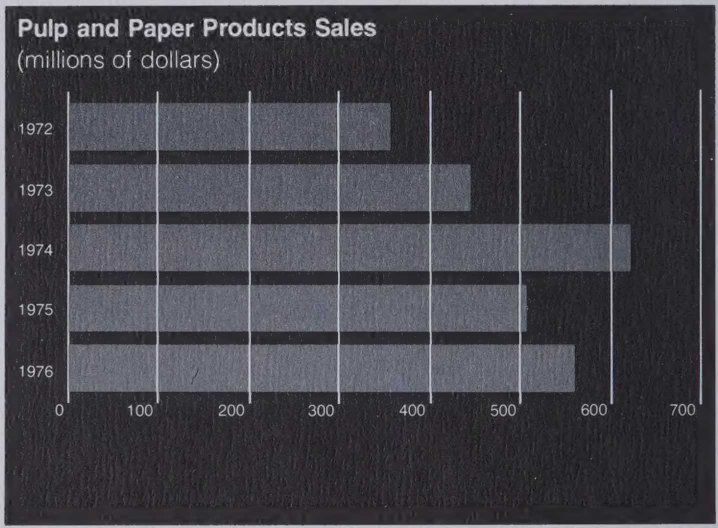
1976 was a most unsatisfactory year for Domtar's pulp and paper companies. Six of the primary producing mills were on strike for most of the first quarter of the year while the balance of the year was marked by soft markets. The operations of the Fine Papers company were the hardest hit. Its mills were the last to reach a labour settlement and, when operations resumed, the domestic fine paper market had been extensively penetrated by imports from the Unites States. Competition from that country remained intensive throughout 1976. It is a serious reality that the pulp and paper industry in Canada is no longer cost competitive with the United States mills due to higher taxes and higher costs for borrowing money, for raw materials, capital equipment and labour — the latter currently exceeding United States levels by 15% to 20%. Moreover, the excessive number of production days lost through labour disputes is earning Canadian producers the reputation of being unreliable suppliers in both domestic and export markets.

Due to these unfavourable factors, it was not possible to increase prices on the majority of goods produced. Such increases as were introduced were certainly not commensurate with the rises in costs nor with the maximum amounts allowable by the Anti-Inflation Board (A.I.B.). It is significant, however, that the labour settlements finally reached with the unions were at the maximum permitted by A.I.B. regulations.

The combination of all these factors, together with the apparent reluctance of governments to acknowledge the value and role of a flourishing, resource based free enterprise sector within the Canadian economy, has discouraged most Canadian producers from committing themselves to major new pulp and paper developments and has created a climate of uncertainty for non-Canadian investors in the pulp and paper sector.

During 1976, capital expenditures and investments amounted to $35 million. These moneys were spent largely on projects initiated before the A.I.B. program of controls went into effect and also before the sharp decline in profits of the pulp and paper companies. The Woodlands company accounted for about $7 million, of which the major amount was $4.3 million for the acquisition of Transcontinental Timber Company Limited. During the year, construction of a stud mill at Lebel-sur-Quévillon, Quebec, and of a random length sawmill at Dolbeau, Quebec, was completed. The latter was undertaken by Murdock-Domtar Inc., a joint venture of Murdock Lumber Inc. and Domtar. The start-up of these two facilities will make Domtar one of the larger producers of quality kiln dried eastern spruce lumber products in Eastern Canada.

Domtar Pulp Limited spent about $8 million on capital projects, of which the installation of a new steam power boiler in the Quévillon mill was the most important. When completed in 1977, the boiler will be capable of being fired by either fuel oil or waste wood materials. Oil energy costs will be substantially reduced when the unit is fired with wood waste residues.



Domtar Newsprint Limited had capital expenditures of about $8 million. The principal item was the replacement of the drive and dryer sections of one of the two paper machines in the Dolbeau mill. The second machine will be similarly modernized during 1977.

Domtar Packaging Limited spent about $5 million on capital projects. Among these were programs to improve the cost competitiveness of the linerboard mill at Red Rock, Ontario, and the corrugating medium mill at Trenton, Ontario, which supply the raw material needs of the group's corrugated container plants. Projects amounting to approximately $2 million were carried out in the corrugated container plants to improve equipment and production facilities and increase capacity. Additional manufacturing equipment was acquired for the Composite Can division so as to broaden its product lines to include containers for fruit juices, refrigerated dough and snack foods.

Domtar Fine Papers Ltd. spent about $6 million on new projects aimed principally at rendering the manufacturing facilities for coated and uncoated paper and board at the Cornwall, Ontario, mill more cost competitive internationally.

Late in 1976, Domtar acquired McFarlane, Son & Hodgson (Limited), a long established fine paper and stationery merchant with operations in Ontario, Quebec and the Maritimes. This acquisition will strengthen the marketing position of Domtar Fine Papers in Eastern Canada.

A 50% interest in Dominion Envelope Company Limited, based in Toronto, was purchased late in 1975. Additional shares were acquired at the end of 1976, resulting in that company becoming a subsidiary. The results of its operations for the year were very good.

The year 1977 will be a difficult one for the primary producing mills of the company. Costs of labour, wood, freight, chemicals and, particularly, energy in the form of natural gas, oil, and electric power will keep on rising and the oversupply of most forest products in relation to demand will continue. Market forces during the early part of the year will dictate reductions in some selling prices while, in other sectors, some modest upward adjustments in prices will be possible. The lower value of the Canadian dollar will provide some short term relief especially if it remains below par with the United States dollar. Thus, during 1977, management will give top priority to rigorous cost reduction, product rationalization, increased productivity and the control of working capital.

Principal Products:

Domtar Fine Papers Ltd. — Uncoated and coated fine papers for the printing, business and converter trades as well as specialty papers such as diazo base, glassine, greaseproof and carbonizing.

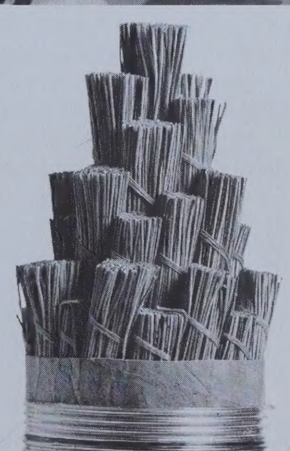
Domtar Newsprint Limited — Standard newsprint; groundwood specialty and coated publication grade papers.

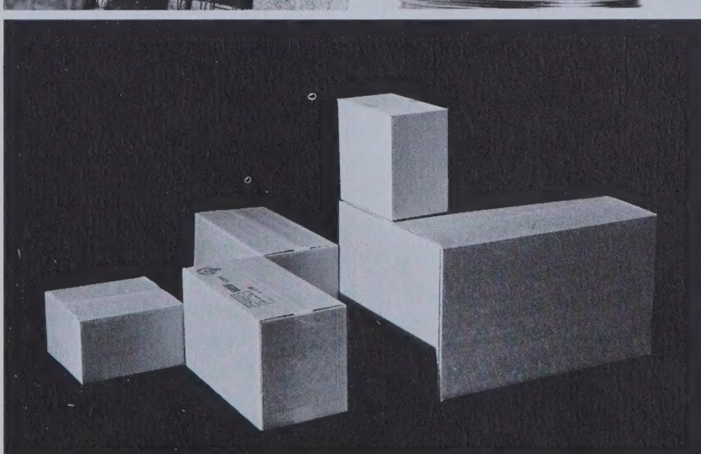
Domtar Packaging Limited — Linerboard, corrugating medium, kraft papers and boxboards for conversion; corrugated shipping containers; packaging and wrapping papers for the consumer trades; grocery and other paper bags; towelling and tissue products; disposable diapers; fibre cans and tubes.

Dominion Envelope Company Limited — An extensive range of envelopes and specialty bags.

Domtar Pulp Limited — Bleached and unbleached softwood and hardwood sulphate pulp; semi-bleached softwood sulphate pulp; unbleached sulphite pulp.

Domtar Woodlands Limited — Green and kiln dried spruce and pine dimension lumber and studs.





Photos:

The largest Canadian manufacturer of printing, writing and specialty papers, Domtar Fine Papers, Ltd. produces some 500 different grades in a wide variety of colours, finishes, weights and sizes.

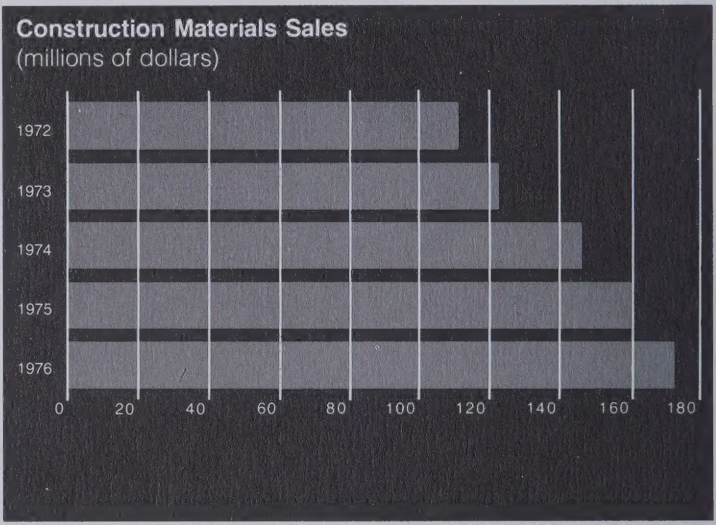
Basic newsprint has been the historical mainstay of Domtar Newsprint Limited, but speciality groundwood papers used for pocket books, brochures, catalogues and various magazines are accounting for an increasing percentage of the company's production and sales.

Domtar pulp is used throughout the world to produce printing and writing papers, board and packaging grades, newsprint and sanitary tissues, as well as insulation for these electrical cables.

Shipping containers for dozens of household items are produced by Domtar Packaging Limited.

Report on Operations
Domtar Construction Materials Ltd.

The year 1976 can be described as a turbulent one of unsatisfactory earnings. Despite record sales of $172.0 million, 7.5% higher than in 1975, operating profit at $10.3 million was a sharp 36% below the previous year and the lowest level attained in the past four years. As might be expected, particularly in view of the overall increase in sales, the income from major product lines was mixed. However, overall results were adversely affected by an unfavourable product mix, work stoppages, start-up costs for new facilities and our general inability to offset cost increases. The cost of manufacturing our products rose more steeply than was the case with the same products made in the United States due to the more rapid increase in our outlays for energy, raw materials and labour. This restricted our ability in several markets and product areas to pass on cost increases while remaining competitive with products imported from the United States and other countries. Furthermore, in several other product lines, the recovery of such increases was delayed by the pre-notification requirements imposed under the price control program of the Anti-Inflation Board.



Sales of resale products, principally Fiberglas® building insulation, were buoyed by energy conservation programs as well as strong residential construction activity and recorded significant gains. However, due to increased distribution and marketing costs, earnings from these sales were disappointing.

Profits were also adversely affected by labour unrest. Serious work stoppages occurred at three major locations and strikes by the construction trades in Quebec and British Columbia added to the problem. The escalation in the cost of materials moderated somewhat from the rate experienced in recent years. However, prices for raw materials derived from petroleum products continued to rise sharply, as did energy costs.

The year began with an active building construction program strongly supported by the residential sector. Demand was further stimulated by a high level of housing starts, 280,000 units seasonally adjusted, in the first quarter of 1976. While this high level was not maintained throughout the year, approximately 273,000 unit starts were achieved, well above the Federal government's target for 1976. Combined with a high level of completions, this resulted in the highest level of residential expenditures on record. Other sectors of building construction expenditure were essentially at the same level as in 1975 although contract awards in these sectors declined markedly in the second half of the year. Strong market demand during the first half of the year, coupled with our work stoppages, heavily taxed many of our manufacturing facilities and resulted in a less than satisfactory level of customer service. As housing activity declined, market demand eased and, at the close of the year, most products were in free supply.

Capital expenditures in 1976 totalled approximately $8 million. The particleboard and Cladboard® decorative panel plant in Huntsville, Ontario, was completed and officially opened on September 16. Although considerable start-up problems were experienced, based on progress to date it is anticipated that these will be overcome early in 1977 and that the plant will be capable of operating at full capacity at that time.

The highly automated facilities at Huntsville were designed to meet the growing needs for a high quality substrate and decorative material for the office, dinette, institutional and occasional furniture markets as well as for panelling. Consideration of the highly sensitive environmental surroundings had to be an important factor in the design. The excellent results achieved reflect the effort made. Asphalt shingle capacity was increased at the Lachine, Quebec, plant. The balance of the expenditures was directed to reducing costs, increasing productivity and the normal replacement of plant and equipment. We announced our intention to undertake a major expansion of the capacity of the Caledonia, Ontario, gypsum wallboard plant. Following several years of unsatisfactory results, our Arborite Limited operations in the United Kingdom were sold to Formica Limited, a subsidiary of The De La Rue Company Limited.

The current outlook is one of uncertainty. It is generally accepted that there will be a decline from the relatively high level of 1976 housing starts. However, estimates for 1977 of approximately 235,000 units, combined with the continuing increase in home renovation, indicate a strong market potential. One area of concern is the current level of inventories of available houses and the influence which this will have on 1977 housing programs.

Unfortunately, the continuation of government assistance programs is essential if housing for low income families is to be ensured. Even with such assistance, the shortage of serviced land in some areas, resulting in further price escalation, makes this objective difficult to attain. The level of non-residential construction projected for 1977 is not expected to vary appreciably from the previous two years. This apparent stability is attributable entirely to the time delay required for completions, as awards of building contracts in this market sector are currently projected to be slow, particularly during the first half of 1977.

Principal Products:

Clay brick; asphalt shingles; roll roofing; roof, sheathing and panel board and CEL-U-CON® 25 non-combustible roofboard; ceiling tiles and grid panels; linear ceiling systems; partition systems; gypsum lath, wallboard and wall panelling; plasters; ARBORITE® decorative and industrial plastic laminates; particleboard and CLADBOARD® decorative laminates; HAYDITE® lightweight aggregate; plastic conduit; Fiberglas® building insulation.

®Registered Trade Mark

Photos:

Bricks manufactured by the Clay division of Domtar Construction Materials Ltd. are used extensively in Canada's residential, commercial and institutional building markets.

P.V.C. conduit is sold to public utilities mainly for underground installation of cables.

Domtar's wide range of movable partition and ceiling systems is especially suited to commercial, institutional and industrial buildings.

The company's new $23 million CLADBOARD® plant at Huntsville, Ontario, has been engineered to produce a high quality board and a decorative CLADBOARD® primarily for the kitchen cabinet and furniture manufacturing industries.

The company also manufactures a broad range of roofing products including asphalt shingles.

®Registered trade mark

Report on Operations
Domtar Chemicals Limited

The optimistic forecast for 1976 made in late 1975 was not realized. Whereas sales increased by 4.7%, profits from operations declined by 12.2% after including gains of $2.5 million from rationalization programs and facility disposals. The concerns expressed in the 1975 Annual Report proved to be fully justified. Labour unrest, mainly in customer operations, had a serious impact not only on our profits but also on our ability to maintain planned levels of capacity utilization and employment. In addition, the Anti-Inflation Board had an influence on our below plan achievement. Although the company generated no excess revenue, the time which management devoted to coping with changing anti-inflationary concepts, regulations and forms significantly diluted its efforts to run the business. The wage guidelines proved to be an additional negative influence created by the anti-inflation program. Establishing a floor for the expectations of organized labour led to protracted negotiations with a resulting reduction in labour effectiveness.

The sale of the Metal Powders division late in the year to an integrated producer will enhance its future growth as well as the job security of its employees. The selling price, which substantially exceeded the book value, contributed significantly to profits.

Three Wood Preserving plants at Transcona, Manitoba, Prince Albert, Saskatchewan, and Brazeau, Alberta, were closed shortly before year-end. These facilities had become high cost producers and required substantial new investment which could not be justified by local market demand. The sale of these assets enhanced our operating results.

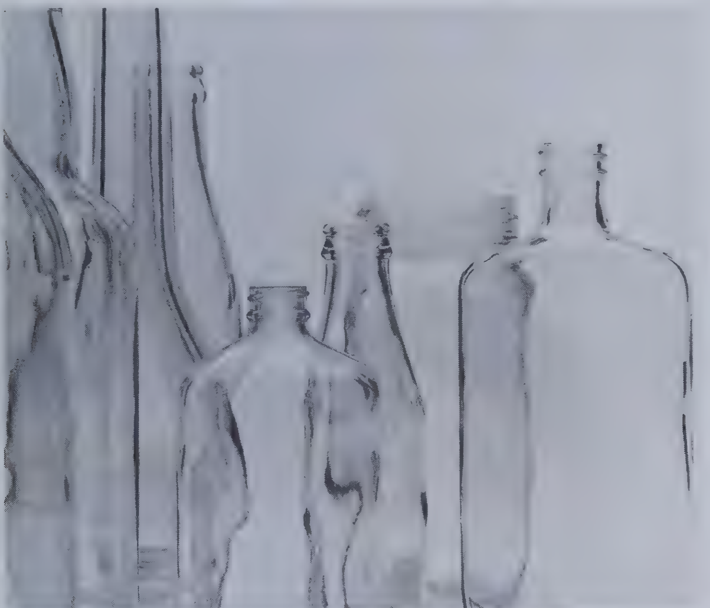
A factor which significantly influenced the decision with regard to the Prince Albert facility was the construction by the Provincial government, with public funds, of an extremely large wood preserving plant with substantial overcapacity in relation to demand. This eliminated the normal utility pole and highway markets available to us and promised to depress selling prices to a point at which private enterprise, with its need to provide for plant and equipment replacement out of generated profits, could not exist.

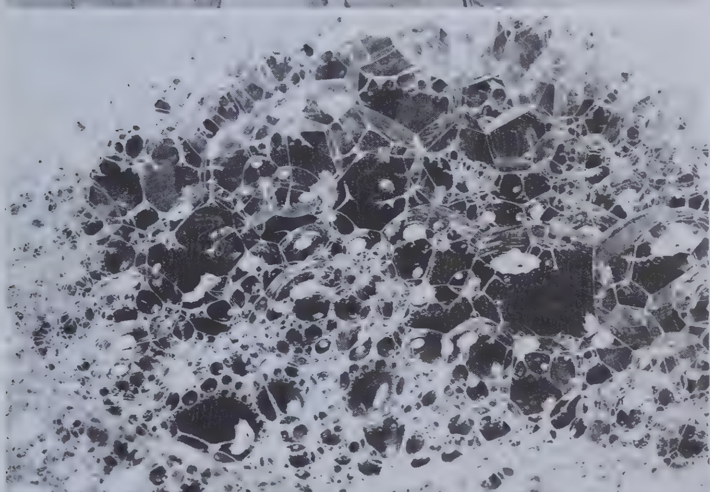
Chemical Developments of Canada Limited penetrated several new markets in its thrust to develop new products and new applications for existing products. A modest increase in performance is anticipated in 1977. Sales are expected to increase by over 10% but operating profit will be less than this figure due to anticipated increases in raw material and transportation costs. Substantial expansion of its specialty chemical business in Canada and the United States is planned and 1977 should see significant progress in this direction.

The Tar & Chemical division was adversely affected by customers' strikes which shut down the Sault Ste. Marie, Ontario, facility for over six months and prevented other plants from operating at capacity. Demand for creosote was as planned due to the active railway tie treatment program. Markets are expected to return to normal in 1977 with a 50% increase in sales and a substantially improved profit performance.

The Wood Preserving division was adversely affected by continuing high customer inventories of utility poles and low consumption due, in part, to labour unrest. The volume of railway ties treated was above normal. While this had the effect of sustaining plant operations and continuity of employment, it did not make a corresponding contribution to profits. A strike at the Trenton, Ontario, plant caused a loss of market share which will jeopardize the employees' future job security. Operations in 1977 are expected to be depressed due to the continuing low demand from public utilities. Seven labour contracts which are to be negotiated could adversely affect labour performance. Should additional plants become uneconomic, further permanent closures could follow.

The industrial minerals divisions, Lime and Sifto Salt, suffered for most of the year from similar market disruptions due to strikes. High demand in the United States steel industry enabled the Lime division to record a creditable profit performance. The outlook for the division in 1977 is for a modest increase in sales and profits due mainly to increased demand from the United States. A lengthy strike at the Unity, Saskatchewan, plant in 1975 adversely affected the Sifto Salt division by causing a loss of markets, notably in Western Canada. The performance of the Cote Blanche, Louisiana, mine improved appreciably due to market rationalizations which enabled salt shipments to be made to the East and West coasts of Canada. In 1977, a record profit performance for this division should result from an increased share of the ice control, general trade and industrial salt markets in the United States, the recovery of our general trade position in Canada and the maintenance of our historical share of other markets.





About $5 million was spent on various capital projects in 1976. To maintain market position and cost competitiveness, capital expenditures are planned which will bring new capacity into production in late 1978. It is also proposed in 1977 to make major capital outlays in Central and Western Canada and the United States. However, the programs will be carefully reviewed in the light of the economic, political and social climate and trends which could significantly influence current intentions of investing approximately $16 million during 1977.

In summary, we view 1977 with little optimism. We do not expect to match our 1975 performance and anticipate only a marginal improvement over 1976 results. The Chemicals company has operated competitively on the North American market. However, unless there is a reversal of the current trend in Canada of continuing, disproportionately higher labour settlements combined with inflated equipment replacement expenditures and growing energy costs, our Canadian operations are likely to become non-competitive outside of Canada and increasingly exposed to the encroachment of foreign suppliers upon our domestic markets.

Principal Products:

Pressure treated and fire retardant wood; coal tar pitches and acids; creosote; naphthalene and phthalic anhydride; limestone; hydrated lime and quicklime; SIFTO® products — ice control, chemical, industrial and table salt; synthetic detergents; wetting agents; carboxymethylcellulose; dyestuffs and pigments.

®Registered Trade Mark

Photos:

The Lime division of Domtar Chemicals Limited produces pulverized limestone for glass manufacture, building supplies and agriculture.

Chemical Developments of Canada Limited produces a wide range of organic speciality chemicals such as formulated liquid detergents.

The Wood Preserving division uses chemical preservatives to give its timber products a service life of up to 70 years. The major pressure treated commodities are power and communication poles, railway ties, marine and foundation piles, bridge timber culverts, fence posts, construction poles, plywood, highway guard rails, sign posts and, more recently, wood foundations.

Consolidated Statement of Earnings and Retained Earnings

year ended December 31

	1976	1975
Revenue:		
Sales	**$886,768,907**	$815,221,364
Investment and sundry income	**9,608,165**	8,106,321
Gain on disposal of fixed assets	**1,612,051**	3,751,146
	897,989,123	827,078,831
Expenses:		
Cost of sales and selling and administrative expenses	**828,692,270**	725,548,977
Depreciation	**35,455,101**	31,695,409
Interest on funded debt	**13,292,673**	8,624,201
Interest on other indebtedness	**959,677**	913,330
	878,399,721	766,781,917
Earnings before income taxes and minority interest	**19,589,402**	60,296,914
Current income taxes	**3,730,000**	11,930,000
Deferred income taxes	**4,170,000**	11,970,000
Minority interest	**1,126,785**	1,109,400
	9,026,785	25,009,400
Net earnings	**10,562,617**	35,287,514
Retained earnings at beginning of year	**193,390,735**	182,362,092
	203,953,352	217,649,606
Dividends:		
Preference shares, $1 per share	**535,191**	535,191
Common shares, $1 per share (1975 — $1.60)	**14,827,300**	23,723,680
	15,362,491	24,258,871
Retained earnings at end of year	**$188,590,861**	$193,390,735
Earnings per common share	**$0.68**	$2.34

See accompanying summary of accounting policies and notes to financial statements

Domtar Limited and Subsidiary Companies

Consolidated Statement of Changes in Financial Position

year ended December 31

	1976	1975
Funds provided by:		
Net earnings	**$ 10,562,617**	$ 35,287,514
Gain on disposal of fixed assets	**1,612,051**	3,751,146
	8,950,566	31,536,368
Depreciation	**35,455,101**	31,695,409
Deferred income taxes	**4,170,000**	11,970,000
Minority interest	**1,126,785**	1,109,400
Other	**85,679**	—
Cash flow from operations	**49,788,131**	76,311,177
Issue of funded debt	**48,854,152**	49,006,205
Sale of investments	**1,235,000**	10,354,287
Disposal of fixed assets	**2,983,300**	3,869,109
	102,860,583	139,540,778
Funds used for:		
Fixed assets	**42,946,960**	56,932,267
Funded debt	**8,897,000**	7,986,000
Minority interest	**1,058,672**	1,122,161
Investments and advances	**680,118**	5,556,993
Dividends	**15,362,491**	24,258,871
Purchase of subsidiary companies, less $6,618,914 working capital at acquisition	**5,144,067**	—
	74,089,308	95,856,292
Increase in working capital	**28,771,275**	43,684,486
Working capital at beginning of year	**219,192,639**	175,508,153
Working capital at end of year	**$247,963,914**	$219,192,639
Changes in components of working capital:		
Receivables	**$ 18,888,369**	$ (18,594,117)
Inventories	**5,626,483**	(7,204,908)
Prepaid expenses	**851,533**	(130,778)
Payables	**(8,773,796)**	(7,099,455)
	16,592,589	(33,029,258)
Income and other taxes	**1,755,149**	35,843,310
Dividends payable	**2,981,621**	7,270
Funded debt due within one year	**(512,000)**	—
Net cash	**7,953,916**	40,863,164
Increase in working capital	**$ 28,771,275**	$ 43,684,486

See accompanying summary of accounting policies and notes to financial statements

Domtar Limited and Subsidiary Companies

Consolidated Balance Sheet

December 31

	1976	1975
Assets		
Current assets:		
Cash and short-term investments, at cost (approximates market value)	**$ 94,697,172**	$ 86,780,262
Receivables	**130,946,908**	112,058,539
Inventories	**145,892,291**	140,265,808
Prepaid expenses	**3,513,239**	2,661,706
	375,049,610	341,766,315
Investments and advances:		
Listed securities	**3,453,801**	3,453,801
Other investments and advances	**8,389,299**	10,849,181
	11,843,100	14,302,982
Fixed assets:		
Plant, machinery and facilities	**777,873,918**	743,466,245
Timber limits and land	**34,205,055**	28,447,942
	812,078,973	771,914,187
Less: Accumulated depreciation	**433,377,428**	407,608,849
	378,701,545	364,305,338
Intangible assets and deferred charges:		
Goodwill	**960,947**	—
Unamortized debt discount and expenses	**1,348,964**	993,795
	2,309,911	993,795
	$767,904,166	$721,368,430

APPROVED BY THE BOARD:

A. D. Hamilton, Director

M. C. G. Meighen, Director

Liabilities and Shareholders' Equity

	1976	1975
Current liabilities:		
Bank indebtedness	**$ 7,765,135**	$ 7,802,141
Payables	**111,201,608**	102,427,812
Income and other taxes	**4,413,507**	6,168,656
Dividends payable	**3,193,446**	6,175,067
Funded debt due within one year	**512,000**	—
	127,085,696	122,573,676
Funded debt	**190,499,000**	150,101,000
Deferred income taxes	**102,542,500**	97,747,000
Minority interest	**13,865,298**	12,235,208
Shareholders' equity:		
Capital stock—		
$1 cumulative redeemable preference shares, par value $23.50, redeemable at $25		
Authorized — 542,445 shares		
Outstanding — 535,191 shares	**12,576,989**	12,576,989
Common shares without nominal or par value		
Authorized — 25,000,000 shares		
Outstanding — 14,827,300 shares	**132,743,822**	132,743,822
Retained earnings	**188,590,861**	193,390,735
	333,911,672	338,711,546
	$767,904,166	$721,368,430

See accompanying summary of accounting policies and notes to financial statements

Summary of Significant Accounting Policies

December 31, 1976

The Company follows the generally accepted accounting principles described below. These, together with the notes which follow, should be considered an integral part of the consolidated financial statements.

Principles of consolidation:
The accompanying financial statements include the accounts of Domtar Limited and all its subsidiary companies.

Translation of foreign currencies:
Current assets and current liabilities in foreign currencies are translated into Canadian dollars at current rates of exchange at December 31, 1976 or at rates related to forward exchange contracts. Fixed assets and related depreciation and other long-term assets and liabilities are translated at rates of exchange in effect at the dates of the transactions. Items affecting net earnings (other than depreciation) are translated at the average rates for the year.

Valuation of inventories:
Inventories of pulpwood, raw materials and operating and maintenance supplies are valued at the lower of cost and replacement cost. Finished goods, including work in process, are valued at the lower of cost and net realizable value.

Fixed assets and depreciation:
Fixed assets are recorded at cost. The cost and related accumulated depreciation of items retired or disposed of are removed from the books and any gains or losses are included in the consolidated statement of earnings. Depreciation is provided on the straight-line method using rates based on the estimated useful lives of the assets which are generally as follows:

Production machinery	12 — 16 years
Logging equipment	Up to 6 years
Automobiles	4 years
Buildings	Up to 40 years

Repairs and maintenance are charged against earnings as incurred.

Income taxes:
The Company provides for income taxes on the tax allocation basis. The Company follows the flow-through method of accounting for the 5% federal investment tax credit. The provision for deferred income taxes mainly arises as a result of depreciation being claimed for income tax purposes in excess of amounts of depreciation recorded for financial statement purposes.

Intangible assets and deferred charges:
Goodwill represents the excess of the cost of shares of acquired companies over the values attributed to the underlying net assets. The Company follows the policy of amortizing goodwill on a straight-line basis over periods not exceeding forty years.

Discount and expenses on funded debt are amortized over the terms of the related obligations.

Domtar Limited and Subsidiary Companies

Notes to Consolidated Financial Statements

December 31, 1976

1. Inventories:	1976	1975
Logs and pulp chips	$ 20,699,483	$ 24,393,487
Raw materials and operating and maintenance supplies	60,021,808	56,502,321
Finished goods including work in process	65,171,000	59,370,000
	$145,892,291	$140,265,808

2. Investments and advances:	1976	1975
Listed securities, at cost, quoted value $3,733,500 (1975 — $3,700,750)	$ 3,453,801	$ 3,453,801
Other investments and advances, at cost:		
Secured loans to the Trustees for employees under the Company's stock purchase plan	$ 114,716	$ 326,823
Municipal bonds	—	160,000
Loans, mortgages and debentures	7,850,064	7,987,206
Shares	424,519	2,375,152
	$ 8,389,299	$ 10,849,181

3. Fixed assets:

	Cost	Accumulated depreciation	Net book value
		(millions of dollars)	
December 31, 1976 —			
Plant, machinery and facilities —			
Pulp and paper	$555.3	$293.5	$261.8
Construction materials	108.5	63.4	45.1
Chemicals	110.6	67.7	42.9
Other	3.5	2.8	0.7
Timber limits and land	34.2	6.0	28.2
	$812.1	$433.4	$378.7
December 31, 1975 —			
Plant, machinery and facilities—			
Pulp and paper	$520.9	$269.6	$251.3
Construction materials	106.0	64.8	41.2
Chemicals	107.7	63.5	44.2
Other	8.9	4.7	4.2
Timber limits and land	28.4	5.0	23.4
	$771.9	$407.6	$364.3

Notes (continued)

	Maturity	1976	1975
4. Funded debt:			
Domtar Limited —			
Sinking fund debentures —			
5¼% Series "A"	1978	**$ 7,404,500**	$ 8,190,000
6¼% Series "B"	1980	**4,274,000**	4,741,000
5½% Series "C"	1982	**7,731,000**	8,845,000
5¾% Series "D"	1984	**10,244,000**	11,081,000
5⅝% Series "E"	1990	**28,046,000**	29,411,000
6¾% Series "F"	1987	**30,617,000**	32,166,000
11% Series "G"	1995	**50,000,000**	50,000,000
9⅝% Series "H" (U.S. $50,000,000)	1996	**49,295,000**	—
St. Lawrence Corporation Limited —			
First mortgage sinking fund bonds — 5% Series "C"	1978	**3,574,000**	3,792,000
Sinking fund debentures — 6¾% Series "A"	1980	**5,861,000**	6,711,000
		197,046,500	154,937,000
Less: Held for sinking fund		**6,035,500**	4,836,000
		191,011,000	150,101,000
Less: Due within one year		**512,000**	—
		$190,499,000	$150,101,000

Instalments due in each of the next five years:
1977 — $512,000 1978 — $10,562,000 1979 — $6,192,000 1980 — $11,050,000 1981 — $7,600,000

5. Acquisitions:

During the year, under agreements to purchase, the Company acquired directly or through subsidiary companies, a controlling interest in certain companies. These acquisitions were accounted for on the purchase method and their operating results have been included from the date of acquisition. The net assets acquired are recorded at fair value with any excess cost of acquisitions being recorded as goodwill.

The net assets acquired and consideration given for these acquisitions are as follows:

Net tangible assets acquired at book value	$ 7,294,054
Adjustment of net assets acquired to fair value	5,412,980
Excess of cost over fair value of net tangible assets	960,947
	$13,667,981

Net assets acquired for cash:	
Investments in prior year	$ 1,905,000
Controlling interest acquired during year	11,762,981
	$13,667,981

Notes (continued)

	1976	1975
6. Minority interest:		
Preferred share equity in subsidiary companies — St. Lawrence Corporation Limited — 70,933 5% preferred shares of $100 each, redeemable at $101 (after purchase for cancellation during the year of 4,292 shares)	**$ 7,093,300**	$ 7,522,500
Other	**411,450**	—
	7,504,750	7,522,500
Common share equity in subsidiary companies	**6,360,548**	4,712,708
	$13,865,298	$12,235,208

7. Pension plans:

The Company and its subsidiaries have pension plans for their employees. The cost charged against earnings in 1976 was $8,831,938 (1975 — $7,508,060). The liability for benefits in respect of past service remaining to be charged to operations approximated $24,638,000 at December 31, 1976. This cost will be charged to earnings over the next fourteen years.

8. Information on directors and officers:

	Number		Remuneration	
	1976	1975	**1976**	1975
Directors	**13**	14	**$ 83,466**	$ 95,008
Officers	**24**	24	**1,576,372**	1,568,338
Officers who are also directors	**2**	2		

9. Sales by class of business:

	1976	1975
	(millions of dollars)	
Pulp and paper products	**$561.8**	$508.9
Construction materials	**172.0**	160.1
Chemicals	**153.0**	146.2
	$886.8	$815.2

10. Commitments and contingent liabilities:

The Company and its subsidiaries are contingently liable for $13,600,000 (1975 — $14,300,000) as guarantor of obligations of other companies and CMHC mortgages on employee homes.

Of the 1977 capital expenditure program the Company is committed for approximately $10,000,000 (1975 — $19,000,000).

There are outstanding lawsuits and claims against the Company as follows:

(a) Proceedings instituted by certain Cree Indians alleging that the mercury content of the environment has partly been caused by mercury discharges of the Company's chemical plant at Lebel-sur-Quévillon, Quebec, and that they have exclusive rights to a territory in Northern Quebec including the location of the Company's Lebel-sur-Quévillon pulp mill complex. They are claiming from the Company, jointly and severally with several other companies, an amount of approximately $5,200,000 in damages. In addition, they request that the Company be evicted from that area.

(b) Various sundry lawsuits and claims amounting to $7,000,000 in the aggregate.

The Company is contesting these lawsuits and claims and does not consider that their outcome will have a material adverse effect on the Company and its subsidiaries.

11. Anti-inflation program:

The Company and its Canadian subsidiaries are subject to controls on prices, profits, employee compensation and dividends under the federal anti-inflation program enacted on October 14, 1975. The Company is of the opinion that it has complied with this legislation.

12. The Companies Act of British Columbia:

These financial statements comply with the disclosure requirements of the act of incorporation (The Canada Corporations Act) and the securities legislation of certain provinces in Canada, but do not purport to comply with all disclosure requirements of the Companies Act of British Columbia.

Auditors' Report

To the Shareholders of
Domtar Limited:

We have examined the consolidated balance sheet of Domtar Limited as at December 31, 1976 and the consolidated statements of earnings and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1976 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

PRICE WATERHOUSE & CO.
Chartered Accountants

Montreal, January 26, 1977

Domtar Limited and Subsidiary Companies

Historical Review

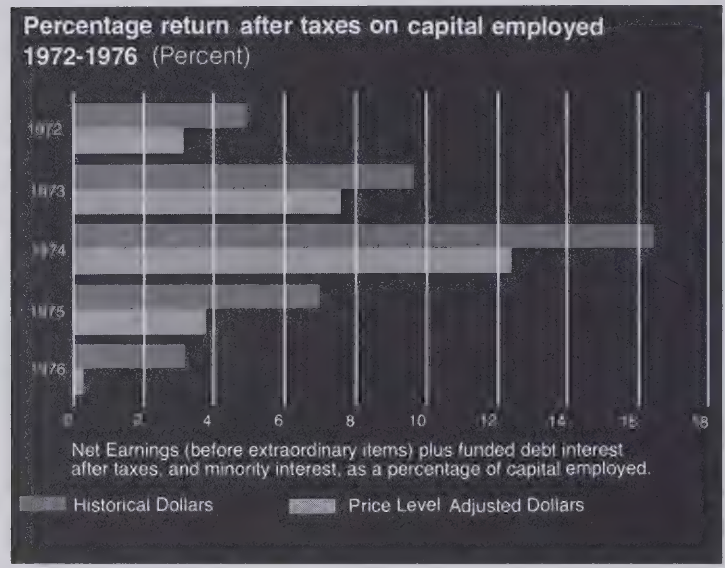
(Dollars in millions except per share amounts)

FINANCIAL	1976	1975	1974	1973	1972
Sales and other revenues:					
Pulp and paper	**561.8**	508.9	622.9	442.0	364.5
Chemicals	**153.0**	146.2	130.7	91.7	85.4
Construction materials	**172.0**	160.1	144.1	122.1	110.9
Other revenues	**11.2**	11.9	9.0	6.3	1.4
	898.0	827.1	906.7	662.1	562.2
Earnings:					
Earnings before income taxes	**18.5**	59.2	147.0	67.2	31.0
Current income taxes	**3.7**	11.9	55.6	21.4	8.3
Deferred income taxes	**4.2**	12.0	8.9	5.2	5.3
Net earnings	**10.6**	35.3	82.5	40.6	17.4*
Cash flow from operations	**49.8**	76.3	123.6	73.7	50.4
Capital investments	**48.1**	56.9	73.8	42.1	28.5
Net assets:					
Net fixed assets	**378.7**	364.3	339.2	294.8	295.8
Working capital	**248.0**	219.2	175.5	152.4	130.2
Investments and advances	**11.8**	14.3	19.1	26.4	26.4
Intangible assets and deferred charges	**2.3**	1.0	—	—	—
	640.8	598.8	533.8	473.6	452.4
Represented by:					
Funded debt	**190.5**	150.1	108.1	115.2	123.0
Deferred income taxes	**102.5**	97.8	85.8	76.5	71.3
Minority interest	**13.9**	12.2	12.2	11.6	12.4
Shareholders' equity	**333.9**	338.7	327.7	270.3	245.7
	640.8	598.8	533.8	473.6	452.4
Per common share:					
Earnings	**0.68**	2.34	5.53	2.70	1.14*
Dividends	**1.00**	1.60	1.60	1.00	0.60
Cash flow	**3.32**	5.11	8.30	4.93	3.36
Shareholders' equity	**21.67**	22.00	21.25	17.33	15.63
Other statistics:					
Number of preference shareholders	**1,613**	1,654	1,671	1,784	1,825
Number of common shareholders	**23,330**	25,815	26,920	27,705	34,824
Common shares outstanding	**14,827,300**	14,827,300	14,827,300	14,827,300	14,827,300
Number of employees	**17,520**	17,637	18,450	18,017	17,436
Employees' salaries, wages and benefits	**273.9**	232.9	230.7	195.1	175.4

*Before deducting extraordinary items of $4.1 million ($0.28 per common share) in 1972.

PULP AND PAPER PRODUCTION (tons)	1976	1975	1974	1973	1972
Newsprint	**199,192**	234,106	311,996	354,020	380,749
Kraft paper and board	**354,213**	300,219	453,990	449,690	433,664
Fine and specialty papers	**350,985**	265,858	372,587	384,012	328,495
Market pulp	**160,802**	160,648	253,078	234,357	265,600
	1,065,192	960,831	1,391,651	1,422,079	1,408,508

Inflation Accounting



In 1976, inflation continued to be a significant factor in the Canadian economy even though it has declined from the levels of recent years. The methods to account properly for the impact of inflation are presently being examined in many countries including Canada. However, industry, the financial community and the accounting profession have not come to a consensus on a method of inflation adjusted accounting which should be adopted for financial reporting purposes.

The Company included supplemental statements in its Annual Report for the years 1974 and 1975 based on the general price-level concept. This concept was at that time accepted by the Canadian Institute of Chartered Accountants and endorsed by the Canadian Pulp and Paper Association as a method by which conventional historical cost financial statements could be amended to show the effects of inflation. General price-level restatement adjusts historical cost information for the decreases in general purchasing power. The deficiency of this concept relates to the use of a single measure of the change in the value of the monetary unit. Unless specific prices relating to a business have moved in an identical fashion, the use of a single measure of purchasing power change does not provide management with sufficiently precise information. Despite its limitations, the use of the general price-level concept recognizes in part the effect of changing prices and to that extent may be considered useful pending the development of a more meaningful concept.

Price-level adjusted figures have again been prepared for 1976 using the Consumer Price Index. In view of current developments which are directed towards the identification of more appropriate inflation accounting methods, particularly those which deal more specifically with current value measurements, the detailed summary of results and capital employed reported in prior years has been omitted from the Annual Report.

The application of price-level accounting concepts has the effect of restating the 1976 reported earnings of 68 cents per common share to a loss of 58 cents per common share.

A major impact of the application of price-level accounting as indicated on the graph is the reduction in the return on capital employed from 3.1% and 6.9% to 0.2% and 3.7% for 1976 and 1975 respectively.

Inflation accounting has become an issue of international concern. Exposure drafts, discussion papers and pronouncements have been issued by the professional accounting bodies in the major developed countries. In Great Britain, the Accounting Standards Committee has introduced proposals for inflation accounting which will require most stock exchange listed corporations to disclose current cost information in their annual financial statements by 1978.

In March, 1976, the Securities and Exchange Commission in the United States issued an Accounting Series Release which will require certain larger corporations which register with the Commission to provide financial disclosure of the current replacement cost of inventory and cost of sales, together with the replacement cost of productive plant and equipment and annual depreciation calculated on a replacement cost basis.

The Canadian Institute of Chartered Accountants recently prepared a discussion paper on current value accounting. A technical committee of the Institute, which includes representation from the Department of Finance of the Federal government, is now consulting widely on the practical problems of its implementation. The Company is actively participating in the work of this committee. The Province of Ontario has recently established a committee to study the impact of inflation on corporate finances and recommend a program of financial disclosure of the impacts of inflation in Ontario.

The Company is working closely with the Canadian Pulp and Paper Association to further research inflation accounting. Preliminary studies with the use of replacement values for fixed assets indicate a more significant adverse impact on earnings than the use of the general price-level concept. The Company is also committed to continue its participation with industry, government and professional bodies to develop a more meaningful profile of financial position during inflationary periods.

Directors and Officers

Directors

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Chairman of the Board,
Canadian Tire Corporation Limited

H. Roy Crabtree, Montreal,
Chairman and President,
Wabasso Limited

A. L. Fairley, Jr., Birmingham, Ala.,
President and Chief Executive Officer,
Hollinger Mines Limited

Roger T. Hager, Vancouver,
Director, The Canadian Fishing Company Limited

Alex D. Hamilton, Montreal,
President and Chief Executive Officer,
Domtar Limited

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Partner in the legal firm of Ogilvy, Montgomery, Renault, Clarke, Kirkpatrick, Hannon & Howard

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Roger Létourneau, Q.C., LL.D., Quebec,
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Argus Corporation Limited

John A. McDougald, Toronto,
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Argus Corporation Limited

Maxwell C. G. Meighen, O.B.E., Toronto,
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Canadian General Investments Limited

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Vice Chairman and Managing Director,
Central National Corporation

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President, Chromasco Limited

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H. Roy Crabtree
Alex D. Hamilton
A. Bruce Matthews
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President and Chief Executive Officer

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Vice-President

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Vice-President

S. A. Kerr,
Vice-President — Administration and Secretary

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Vice-President

R. G. Martin,
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Vice-President

J. H. Robertson,
Vice-President

J. H. Smith,
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G. H. Tomlinson,
Vice-President — Research and Environmental Technology

G. M. Drodge,
Controller

A. Gascon,
General Counsel and Assistant Secretary

F. E. Hertha,
Treasurer

E. G. Aust,
Assistant Treasurer

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Domtar Construction Materials Ltd.
President — J. Cochran

Domtar Pulp & Paper Products Ltd.
President — J. H. Robertson

Domtar Fine Papers Ltd.
Vice-President and General Manager
J. H. Kila

Domtar Newsprint Limited
Vice-President and General Manager
R. R. Pinard

Domtar Packaging Limited
Vice-President and General Manager
W. R. Lawson

Domtar Pulp Limited
Vice-President — R. R. Pinard

Domtar Woodlands Limited
Vice-President — A. S. Fleming

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for common shares only:
The Bank of New York — New York, N.Y.

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